the abacus

ISSUE 82

GALLOWAY BOTTESELLE & COMPANY
Chartered Professional Accountants

Considering starting a home business?

Planning issues, tax rules and tips to keep in mind

MANY PEOPLE ARE UNCLEAR on the difference between a "corporation" and a "business", but the difference is extremely important, for both tax purposes and liability purposes.

Incorporation

IF YOU CREATE A CORPORATION, it will have “Limited” (Ltd.), “Incorporated” (Inc.), or “Corporation” (Corp.) as part of its name.

The corporation is a **legally separate entity** from you, and the corporation – not you – carries on the business. Although you control the corporation, the business is legally not “your” business. This means that **you are normally not liable for the corporation’s debts**.

It's important to understand that if the corporation needs to borrow money from a bank, the bank will insist on a personal guarantee from you, so in practice you will be liable if the corporation cannot repay the bank loan. Also, as a director, you are liable for certain obligations of the corporation, such as an assessment of goods and services tax/harmonized sales tax (GST/HST) or employee payroll deductions that the corporation fails to remit.

If you create a corporation, the corporation will have to file annual T2 corporate income tax returns and pay tax on its profits. Normally, your corporation will be a “Canadian-controlled private corporation” (CCPC), which pays a special low rate of tax on its first $500,000 each year of active business income (somewhere around 12%, depending on the province). However, this “small business deduction” rate is subject to many complex rules.

The corporation usually must pay monthly instalments to the Canada Revenu Agency (CRA) after its first year of operations, so that it will not have a large tax debt at year-end.

Of course if the corporation is profitable, you want to be able to enjoy those profits. However, **you should not simply take the corporation’s money for yourself**. To extract profits from the corporation, you

SEE **HOME BUSINESS** P. 4

Make money volunteering for a charity

If you volunteer for a charity, you may be able to make a little money at no cost to the charity

The charity cannot give you a donation receipt for services that you provide for free. A valid donation receipt for tax purposes can only be issued for a donation of money or property, but...

Suppose the charity **pays you for your services** and **you donate the money back**?

Unless you are in a fairly high tax bracket (over $155,62 of taxable income after all deductions in 2022), this option can pay off. Donations over $200 per year will give you a 29% federal tax credit plus a provincial credit, for a total savings of about 40-45% depending on the province. If you are in a lower tax bracket, the income you report from the charity will be taxed at a lower rate than the credit you receive. The lower your tax bracket, the higher the differential and thus the more profitable it will be to have the charity pay you.

There are numerous rules, both federal and provincial, that govern charities and their activities, including these three:

- Of course, the amount the charity pays you for your services must be reasonable, or the charity can run into problems if it is audited by the Canada Revenu Agency (CRA).
- As well, if you are a director of the charity (or related to a director), you may not be permitted to be paid by the charity for your services.
- Note also that if you are registered for the goods and services tax/harmonized sales tax (GST/HST), or your revenues from self-employment exceed $30,000 per year, you will be required to charge the charity the GST/HST on your services (unless you are working for it as an employee, in which case it needs to withhold payroll deductions on your pay). However, the charity will be entitled to a rebate for a substantial fraction of this GST/HST.

AROUND THE COURTS

Penalty for over-contribution to TFSA upheld

The background | **As readers** are likely aware, the income tax rules allow you to contribute to certain tax-deferred plans, such as registered retirement savings plans (RRSPs) and tax-free savings accounts (TFSAs). The plans are called tax-deferred plans because the investment income earned in the plans is exempt from tax while in the plan. With an RRSP, amounts withdrawn from the plan are fully included in income (since you get a deduction when you contribute to the plan), while TFSA withdrawals are generally tax-free (since you do not get a deduction when you contribute to the plan).

The tax-deferred plans have monetary limits in terms of how much you can contribute to the plan. **If you go over the limits, you may be liable for a penalty tax and interest.** There are some relieving provisions, one of which was the subject of the recent Posmyk case.

The Posmyk case | **In this case**, the taxpayer overcontributed to his TFSA and the Canada Revenue Agency (CRA) assessed a penalty. The taxpayer appealed to the Tax Court of Canada (the Court).

In general terms, the relieving provision that potentially applied to the taxpayer required that the over-contribution was made "as a consequence of a reasonable error", and that he withdrew the over-contribution from the TFSA "without delay". One of the taxpayer's arguments was that he did not have home Internet access during the taxation years in question (by his own choice) and therefore only checked his email on occasion at the local library, and that he did not receive CRA notifications about his over-contributions.

The ruling | **In its decision**, the Court was sympathetic with the taxpayer: it held that the taxpayer withdrew the amount without delay. Unfortunately, his over-contribution was found *not* to be as a consequence of reasonable error, so the penalty was upheld. His decision not to have Internet access did not change this result. Basically, the Court was saying he was responsible for knowing the TFSA contribution limits even though he did not receive, or was not aware of, CRA notifications.

The lesson | **The lesson here** is that if you have provided your email address to the CRA, then the CRA will **not** send you paper copies of any letters, Notices of Assessment, or other communications. You will instead receive an email notice telling you to log into "My Account" to read your CRA mail. If you don't see that message or don't check "My Account" regularly, you may miss important mail and run into serious tax problems as a result!

HOME BUSINESS CONT'D FROM P. 1

should either have the corporation pay you **salary or bonus** (which the corporation can deduct and is taxable to you as employment income), or have it pay you **dividends** (which are not deductible to the corporation but are taxed to you at a lower rate, due to the dividend tax credit). These steps require certain paperwork, and it is important to document properly what you are doing; otherwise the tax consequences can be serious if you or the corporation are audited. The corporation can also repay to you any money you have loaned to it, with no tax consequences.

Sole proprietorship

YOU CAN CARRY ON BUSINESS without creating a corporation; you may give your business a name but it remains simply **you** carrying on the business as "sole proprietor". This is the case for many home businesses.

There are no legal requirements for operating a sole proprietorship (other than the GST/HST requirements noted below).

Although you are not obligated to have a separate business name, you may wish to create one in order to appear more professional to your clients or customers.

GST/HST

ONCE YOUR TOTAL SALES exceed $30,000 per year (combined with the sales of any corporation you control), you must register for and collect the GST/HST. Until your sales top the $30,000 mark over four consecutive calendar quarters, you do not have to register or charge GST/HST.

But even if you are under $30,000 in sales, if your sales are to businesses rather than consumers, you may wish to register. You will then need to collect the GST/HST from your clients or customers, but they generally will not care since most businesses claim back all GST/HST they pay. You, in turn, will be able to recover all the GST/HST that you pay on your business expenses.

Reporting your income

WHEN YOU ARE CARRYING on a sole proprietorship, any income earned by the business is reported on your tax return under "Business Income".

The tax return requires you to show both gross revenues (total sales) and business income (after expenses). You will also need to file an income statement showing the details of your revenues and expenses (broken down by category, e.g. advertising expenses, office supplies, meals and entertainment, utilities). This is normally done on Form T2125, but is not required to be.

Your net business income is combined with your other sources of income on your income tax return – like employment income and investment income – to reach "total income".

GALLOWAY BOTTESELLE & COMPANY
Chartered Professional Accountants

Accounting for what **matters**™

E. Albert Botteselle, FCPA, FCGA, CFP
Brian R. Blamey, CPA, CGA, BA
David P. Van Gruen, CPA, CGA
Saskia N. Muller, CPA, CGA, BCOM
Selena G. Nisbet, CPA, CGA, BCOM
Mark W.K. Best, CPA, CGA
G. Allyn Fong, CPA, CGA
David Bickerton, CPA

Maple Place Professional Centre
300 – 2000 West 12th Avenue
Vancouver, BC V6J 2G2
T +1 604 736-6581
F +1 604 736-0152
E info@gbco.ca
www.gbco.ca

Published by

PORTER
HÉTU
INTERNATIONAL

Coordination **Kimberly Nguyen**
Design **Tugboat Group**
Art direction **JAM Design**

Please send your comments or questions to Kimberly Nguyen at **knguyen@gbco.ca**

Independent member firm of
PORTER HÉTU INTERNATIONAL
Professional Services Group